United States Court of Appeals

for the Second Circuit

APPELLANT'S BRIEF

74-1433

To be argued by
EDWARD C. KALAIDJIAN

United States Court of Appeals

FOR THE SECOND CIRCUIT

ANNE QUINN CORPORATION and EARL J. SMITH & Co., INC.,
n/k/a U. S. BULK CARRIERS, INC.,

Plaintiffs-Appellees,

against

AMERICAN MANUFACTURERS MUTUAL INSURANCE COMPANY,

Defendant-Appellant.

BRIEF FOR APPELLANT

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BRIEF FOR APPELLANT

American Manufacturers Mutual Insurance Company appeals from a judgment entered January 29, 1974 by the United States District Court for the Southern District of New York (Bonsal, J.), declaring that appellant's ocean marine excess policy DE 3540 had been validly procured and provided appellees excess insurance coverage of their liability for bodily injury, death and property damage claims occasioned by the sinking of the SMITH VOYAGER in December 1964 due to overloading. The judgment was based on the District Court's opinion (15a) dated December 14, 1973 and reported at 369 F. Supp. 1312. Jurisdiction of the appeal is based on Title 28 U.S. Code § 1291.

Issues

1. Did the District Court err in holding that a marine insurance policy which plaintiffs procured without disclosing to defendant their regular overloading of the vessels to be insured, was nonetheless valid and enforce-

able to indemnify plaintiffs for a loss subsequently caused by their deliberate overloading of the SMITH VOYAGER during the policy term?

2. Did the District Court err in holding that plaintiffs' concealment of their overloading of the vessels to be insured was not material to their procurement of a time policy of ocean marine excess insurance?

3. Did the District Court err in holding that knowledge of an alleged usage among shipowners to overload their vessels at Freeport, Bahama Islands, should be imputed to defendant's marine underwriter even though such practice:

(i) was a violation of the Load Line Act, 46 U.S. Code § 85, *et seq.;*

(ii) was criminal misconduct pursuant to 46 U.S. Code § 658;

(iii) was not known to defendant's underwriter; and

(iv) the policy coverage was worldwide for a term and not for a specific voyage, trade or place.

4. Did the District Court err in holding that a custom and usage existed in 1964 among vessel owners carrying grain from United States Gulf ports to the Far East to overload their vessels at Freeport, Bahama Islands?

5. If defendant's ocean marine excess policy were not void because plaintiffs concealed information material to the risk, did the District Court err in failing to hold that plaintiffs' deliberate overloading of the SMITH VOYAGER was "dishonesty or fraud" within Exclusion I(a) of the policy?

Antecedent Litigation

During the term of the policy at issue on this appeal, the SMITH VOYAGER sank in the Atlantic Ocean on December 27, 1964, after departing from Freeport, Bahama Islands, overloaded by 564 tons. In *Petition of Long, et al.*, 439 F. 2d 109 (2 Cir. 1971) this court affirmed a decision of the District Court, 293 F. Supp. 172 (S.D.N.Y. 1969) holding that the SMITH VOYAGER was overloaded with the privity and knowledge of plaintiffs herein, that overloading was a substantial cause of the sinking and that plaintiffs were not entitled to the benefits of the Limitation of Liability Act, 46 U.S. Code § 183, *et seq.*

While plaintiffs' appeal in the limitation of liability case was pending, the SMITH VOYAGER's primary P&I insurer paid the death, injury and property damage claimants a total of $1,821,000, obtaining from each claimant a discontinuance of all litigation only against the vessel owner, Sumner Long, who is not a party in the present case. The limitation claimants were permitted to continue the prosecution of their damage claims against plaintiffs in the limitation action, but their recovery is limited to the amount, if any, by which their provable damages may exceed the settlement payments they have already received.

Subsequently on June 30, 1971, plaintiffs commenced the present action against defendant as excess insurer seeking indemnification for any liability which they may incur in excess of the amounts already paid to each claimant (2a). By stipulation, the limitation claimants were permitted to intervene as parties in the court below because of their potential interest in plaintiffs' claim against the disputed excess policy and the claimants have deferred proof of their damages in the limitation action pending the outcome of the instant case.

Facts

In early August 1964, plaintiffs sought from defendant a $5,000,000 marine excess policy for a term of one year (36a). The requested policy was to insure plaintiffs subject to policy terms for an amount in excess of the limits of underlying or primary policies issued by others against protection and indemnity and other liability risks incidental to their worldwide operation of seventeen designated tramp ships known as the Smith fleet (Exhibit A, 161a). One of the ships, SMITH VOYAGER, was bareboat chartered to Anne Quinn Corporation and operated by Earl J. Smith & Co., Inc., the plaintiffs herein.

The requested marine excess policy was to replace one outstanding with defendant, expiring August 13, 1964 (36a). Since marine insurance policies are not automatically renewable, Mr. Blackman, manager of defendant's marine underwriting department, requested plaintiffs, through their broker, Mr. Lucey of Frank B. Hall & Co., Inc., to answer in writing the questions about their operations on defendant's application form (Exhibit D, 190a). The form called for information about plaintiffs' marine and incidental shoreside operations, the coverage and limits of underlying insurances and the names of the vessels to be insured.

Relying entirely on the information furnished by plaintiffs in the application form, defendant issued ocean marine excess policy No. DE 3540 embodying plaintiffs' requested coverage for a term of one year in consideration of a $7,500 premium (41a, 52a). The only other information defendant had was general data available from public sources such as Lloyd's Register of Ships showing the technical characteristics and date of construction of the ships to be insured and the fleet loss experience record which contained no evidence of any irregularity or violation of law in the operation of the ships (46a).

In the negotiations leading to the issuance of policy DE 3540, plaintiffs did not disclose to defendant that they were regularly overloading the ships to be insured (41a-42a, 82a, 84a-85a). Defendant had no knowledge of any overloading from any other source (52a). Defendant's marine underwriting manager, Mr. Blackman, as well as plaintiffs' broker, Mr. Lucey, each testified that he had no knowledge that any of the ships to be insured were being operated in overloaded condition (41a-42a, 82a, 386a, 388a-389a, 396a).

By contrast, the sinister facts attending plaintiffs' operation of their ships before and after the issuance of policy DE 3540 were summarized in a finding (22a-23a) by the District Court which is not challenged on this appeal:

> "It developed at trial that Marine Consultants & Designers, Inc., a firm of naval architects, made a study of plaintiffs' records pertaining to the alleged overloading of thirteen of the seventeen vessels operated by the plaintiffs and covered by the policy. This study disclosed that between February, 1963 and August 13, 1964 (the inception date of the policy), thirty-seven voyages were made from United States gulf ports to the Far East via Freeport, and on thirty-six of these voyages the vessels departed from Freeport overloaded. With respect to the thirty-seventh voyage, the study concluded that the vessel was 'probably overloaded,' though the specific records to prove it were not available. Subsequent to August 13, 1964, during the period the policy was in effect, Marine Consultants & Designers, Inc. studied nineteen voyages of plaintiffs' vessels from gulf ports to the Far East via Freeport and Ceuta. Of the nineteen voyages, there was evidence of overloading on seventeen. The court finds on the basis of this evidence that the plaintiffs did engage in the practice of overloading their vessels."

Defendant's marine underwriting manager testified that if plaintiffs had disclosed their regular and deliberate overloading of the vessels to be insured, he would have refused to issue policy DE 3540 (84a-85a). In Mr. Blackman's words, the premise that the vessels to be insured would not be overloaded was "fundamental to the acceptance of the risk" (85a). Mr. Dwelly, a retired marine underwriter, testifying for one of the intervenors, acknowledged that overloading of a vessel would be material to the risk of insuring her because it affected the safety of cargo and life at sea (127a-128a).

Policies of marine insurance are contracts of utmost good faith. An insured's concealment or failure to disclose material information which he knows or ought to know, renders a marine policy void and unenforceable. One can scarcely imagine any information more material to the procurement of a marine insurance policy than the insured's regular and deliberate overloading of the vessels to be insured. Upon the foregoing facts, which were not controverted at the trial, the District Court erred in failing to hold that policy DE 3540 was void and unenforceable by reason of plaintiffs' concealment of their habitual and deliberate overloading of their vessels.

The District Court sought to neutralize plaintiffs' nondisclosure of the overloading by imputing to defendant's marine underwriting manager knowledge of an alleged usage among shipowners carrying grain from United States Gulf ports to the Far East to overload their vessels at Freeport. The imputation of that knowledge to defendant's marine underwriter was erroneous for several reasons.

The coverage sought by plaintiffs was not insurance on a particular voyage or even for a specific port, place or area; rather, it was to insure on a time basis certain risks in the worldwide operation of a fleet of tramp steamers. Assuming that a usage among shipowners of overloading at

Freeport had been proven, plaintiffs did not disclose to defendant that the vessels to be insured were calling at Freeport (48a). Consequently, defendant's underwriter was not given facts to charge him with notice that an alleged usage of overloading at Freeport would affect the risks which plaintiffs were asking him to insure.

Moreover, Freeport was not the only port where plaintiffs had been overloading the vessels to be insured when they sought the insurance coverage. The uncontroverted evidence established that plaintiffs overloaded the vessels to be insured at Ceuta (215a), Djibouti (232a), Calcutta (238a), Trinidad (230a), Casablanca (222a), Port Said (220a), Suez (234a), Aden (237a), Augusta (231a) and Bhavnagar (256a). Plaintiffs concealed from defendant the overloading of the vessels to be insured at all these ports. No evidence was presented of any general usage to overload at any of those ports which would render the information concealed immaterial.

This court has held with respect to the SMITH VOYAGER in *Petition of Long*, 439 F. 2d 109 (2 Cir. 1971) that an overloaded vessel is unseaworthy as a matter of law. The so-called custom of overloading at Freeport relied on by the lower court was, in addition, a violation of the International Load Line Convention of 1930 to which the United States subscribed, and a violation of a federal safety statute, the Load Line Act, then embodied in 46 U.S. Code §§ 85-85g. The alleged overloading usage invoked by the District Court is a prima facie violation of Title 46, U.S. Code § 658, which provides that anyone who knowingly sends an American vessel to sea in unseaworthy condition is guilty of a misdemeanor punishable by a fine not to exceed $1,000 or by imprisonment not to exceed five years.

The District Court's opinion reflects no awareness of the settled rule that the courts may not invoke a custom or usage which is immoral or contrary to law and public policy to affect the rights of parties to a contract. The lower

court committed obvious error in relying on an alleged usage which was illegal, criminal, dangerous and immoral. The court cited no precedent or authority permitting it to take cognizance of this repugnant usage.

The foregoing discussion assumes that the nefarious usage was even proven at the trial. One searches the record in vain for evidence that overloading at Freeport during 1964 was certain, definite, general, uniform, reasonable and not in contravention of safety and criminal statutes. Where is the proof as to the number of vessels which called at Freeport in 1964, the number which departed overloaded, the names of the shipowners other than plaintiffs whose regular overloading over a prolonged period constituted a usage? There is none. Scarpello and DiVenti established no usage. Neither did Diamond whose records and testimony were wholly misconstrued by the District Court.

Mr. Diamond identified records of Dyson Shipping Company concerning bulk grain cargoes forwarded for the Indian government during the years 1962 through 1964 (India, Exhibits 1, 2, 3, 422a-452a). Those records showed as to each ship the tonnage of cargo stipulated in its charter (Column 1) and the tonnage actually loaded (Column 10). Mr. Diamond testified (108a-109a) that the chartered tonnage was subject to a leeway of five to ten percent more or less as indicated in Column 1. The Dyson records disclose that in all but three ships (HOEGH EAGLE, 432a, MERMAID, 434a, VASSO, 434a) the tonnage loaded (Column 10) was within the allowable percentage leeway of the tonnage booked (Column 1). The District Court erroneously assumed that a vessel was overloaded if the tonnage loaded exceeded the tonnage chartered even though the excess was less than the authorized percentage leeway. In addition, Mr. Diamond testified that he did not know whether any of the vessels listed in his employer's records had called at Freeport and he had no knowledge

concerning fuel and water consumption of the vessels (115a-116a).

If policy DE 3540 were not void for plaintiffs' non-disclosure of material facts, the losses for which they seek indemnification would be excluded from coverage by the express provisions of the policy (165a). The first of the exclusionary clauses provides:

> "THIS POLICY SHALL NOT APPLY:—
>
> I. (a) to indemnify an Assured whose dishonesty or fraud, committed individually or in collusion with others, caused the loss for which that Assured seeks indemnity."

For reasons unexplained, the District Court noted defendant's assertion of this exclusion, but failed to consider its effect on plaintiffs' claim.

It is well established in the law of marine insurance that a willful exposure of a vessel to a known risk is fraud. The trial record admits of no doubt that the overloading of the SMITH VOYAGER was willful, was consistent with plaintiffs' long standing practice and was directed by an executive officer, Fitzsimmons, who was a Vice-President of both plaintiffs.

Plaintiffs received freight on the number of tons of cargo loaded. They deliberately risked the vessel, its cargo and lives to maximize freight on the overload. The District Court's decision inadvertently sanctions a corrupt "heads I win, tails you lose" game in which shipowners imperil their ships to collect freight on the overload and, if the vessel sinks, they foist their losses on their duped insurers.

If there were any doubt that willful exposure of a vessel to a known risk is "dishonesty or fraud" within the above exclusion, the element of furtiveness was also proven. Plaintiffs sent the SMITH VOYAGER to Freeport for bunkers because the vessel could overload there free of surveillance

by the United States Coast Guard. Plaintiffs' practice of overloading required that their vessels escape detection by enforcement authorities in the many ports where overloading was done.

In consequence, plaintiffs' operations were permeated with a "Watergate" or cover-up atmosphere. Sensing that their standing with plaintiffs depended upon successful overloading, the masters of plaintiffs' ships wrote Fitzsimmons letters from abroad warning him about ports which were strict on overloading and bragging of their surreptitious methods of concealing overloading by taking water after dark, by tying bum boats alongside to hide the vessel's submerged plimsol marks, by causing the vessel to list and by anchoring in surging roadsteads where it was impossible to read the draft (360a-363a). In turn, Fitzsimmons assured masters who were apprehended for overloading that they would get no more than a "slap in the wrist" from the Coast Guard with no suspension of license for their offense (342a).

Paramount considerations of public policy involving the safety of life and property at sea and the proper observance of international conventions and safety statutes will be served by the denial of insurance coverage to shipowners for losses resulting from willful overloading. This case, in which the limitation damage claimants have already received substantial compensation, presents an occasion for the court to reiterate that principle to shipowners.

POINT I

Policy DE 3540 Was Void for Concealment of Material Information.

(a) Concealment of Material Facts

Under well established maritime law applicable to the procurement of marine insurance, a prospective insured is

held to a duty of utmost good faith in voluntarily disclosing to the underwriter every material fact bearing on the risk sought to be insured. The duty extends to all facts known to the insured, as well as those which the insured should have known. A material fact is one which might affect the underwriter's judgment whether to accept the risk and, if so, at what premium. If the insured fails to disclose any such material fact, the policy is voidable at the instance of the insurer.

Btesh v. *Royal Insurance Co. of Liverpool,* 49 F. 2d 720 (2 Cir. 1931);
King v. *Aetna Insurance Co.,* 54 F. 2d 253 (2 Cir. 1931);
Pacific Queen Fisheries v. *Symes,* 307 F. 2d 700 (9 Cir. 1962);
Gulfstream Cargo, Ltd. v. *Reliance Ins., Co.,* 409 F. 2d 974, 980 (5 Cir. 1969);
Neubros Corporation, et al. v. *Northwestern National Ins. Co., et al.,* 1972 A.M.C. 2443 (E.D.N.Y. 1972)—not otherwise reported;
Morton v. *The Home Ins. Co.,* 32 A.D. 2d 621, 299 N.Y.S. 2d 642 (1st Dept. 1969);
Arnould on Marine Insurance, 15th Ed. (1961) § 550;
Couch on Insurance 2d, §§ 38:75-38:77.

The marine insurance rule requiring the disclosure of material facts is not an anachronistic vestige which has ceased to serve any recognizable function. The principles of fair play which it represents are the foundation of modern statutory, regulatory and decisional law governing the sale of securities. See, for example,

15 U.S. Code § 77q;
17 C.F.R. § 240.10b-5;
S.E.C. v. *Texas Gulf Sulphur Co.,* 401 F. 2d 833 (2d Cir. 1968), cert. den. sub nom. *Coates* v. *S.E.C.,* 394 U.S. 976 (1969).

The legal requirement of utmost good faith in the disclosure of material facts derives from the consideration that a marine insurer does not have the same access to essential information as the insured has. When marine insurance is sought, the insured's vessels may be at sea or at some distant port operating under circumstances known only to the insured. Prompt decision is required before investigation can be made.

> *Clarkson* v. *Western Assurance Co.*, 33 App. Div. 23;
> *Hare & Chase Inc.* v. *National Surety Co.*, 60 F.2d 909, 911 (2 Cir. 1932), cert. den. 287 U.S. 662;
> *Gilmore & Black, Law of Admiralty*, § 2-6, p. 57.

Plaintiffs applied to defendant for a time policy insuring for a period of one year risks incidental to the operation of a fleet of seventeen tramp ships. The materiality of the facts which they did not disclose is apparent as a matter of law. Their deliberate and habitual overloading of the vessels to be insured, not only at Freeport but at a dozen other places in the world, was a violation of a safety statute which impaired the seaworthiness of their ships and was the cause of the loss claimed in this action. Defendant's marine underwriter testified that if he had known of plaintiffs' practice of overloading their vessels, he would have refused to insure at any price.

Plaintiffs' answers to the questions on their application for insurance compounded their concealment. For example, in answering the third question (190a) which requested that they describe their operations as completely as possible, they stated only:

> "Ownership—operation of steamships (fleet presently composed of 17 U.S. Flag vessels)".

Plaintiffs did not mention that in their operations, the vessels to be insured frequently bunkered at Freeport.

Nor did they disclose any information tending to suggest that the risk might be affected by any activity at Freeport or elsewhere (48a). The last question (No. 12) on the application (193a) requested that they disclose any other facts "which might affect underwriter's judgment when considering this application". To that question, they responded: "None to our knowledge". Their answer not only misrepresented the material fact of the overloading of the vessels to be insured, but also tended to assure defendant that further inquiry was not indicated. But for plaintiffs' concealment, defendant would not have issued policy DE 3540 to them. A more compelling violation of the disclosure rule applicable to marine insurance can scarcely be imagined. Policy DE 3540 should be adjudged void. The District Court erred gravely in ruling to the contrary.

(b) The Alleged Usage of Overloading at Freeport

Plaintiffs' concealment of the overloading of their vessels at Freeport could not be rendered immaterial by any alleged usage of shipowners to overload at Freeport even if such a usage had been proven. The court's attempt to invoke such a usage, to neutralize plaintiffs' material concealments offends fundamental principles of law and public policy and is predicated on a substantial misconstruction of the evidence.

No precedent permits a court to affect the rights of the parties by a usage which violates a safety statute as well as a criminal statute and imperils the safety of life and property at sea. The court imputed knowledge of this unproven and illegal usage to defendant's marine underwriter although his uncontroverted testimony was that he did not know of it.

The cases on which the lower court erroneously relied in recognizing an illegal usage and imputing knowledge of it are readily distinguishable. *Clark, et al.* v. *Manufacturers'*

Insurance Company, 49 U.S. (8 How.) 235 (1850) involved fire insurance on a factory, not marine insurance. The Supreme Court held that the fire insurance policy was void if the insured falsely represented that a lamp would not be used in the picking room where the fire originated. The court mentioned by way of *dicta* that if the insured had made no representation, the policy would not be void unless the use of a lamp in the picking room were so unusual and risky that concealment of it was fraudulent.

Nor is the lower court's position supported by the Supreme Court's decision in *Buck & Hedrick* v. *Chesapeake Insurance Company,* 26 U.S. (1 Pet.) 151 (1828). That case involved insurances on a ship and its cargo for a specific voyage from Puerto Rico to Baltimore when Puerto Rico had a well-known belligerent status. The Supreme Court held that a request for insurance on property to be shipped from a disclosed belligerent area was an "awakening circumstance" putting the underwriter on notice of a practice by neutrals to cover belligerent property under neutral names. That usage was neither illegal nor dangerous. In the instant case, the insurance which plaintiffs sought from defendant was not a voyage policy between specific places, but rather a time policy to be applicable to the worldwide operation of seventeen tramp steamers.

Where is the evidence that plaintiffs disclosed any "awakening circumstance" sufficient to charge defendant with knowledge that an alleged usage of overloading at Freeport was involved in the risks to be insured? No reference to Freeport appears in plaintiffs' application for insurance (Exhibit D, 191a). No disclosure was made by plaintiffs of any use of Freeport (48a). Plaintiffs communicated no information to defendant which raised any basis for inquiry.

Gulfstream Cargo, Ltd. v. *Reliance Insurance Co.,*
409 F. 2d 974, 982 (5 Cir. 1969).

The decision in *Pelly* v. *Governor and Company of the Royal Exchange Assurance,* 1 Bur. 341 (1757), does not support the District Court's position on usage. The insurance in that case was on a ship for a disclosed round voyage from London to China. It was customary for ships in that trade to store their sails and apparel ashore at Canton while their hulls were cleaned and refitted. A fire consumed the vessel's sail and apparel while in storage there and the insurer refused to pay the loss on the grounds that it did not result from a marine peril. The court held the insurer liable for the loss pointing out that the insurer knew that it was customary in the vessel's trade to store the property ashore while the vessel was cleaned and refitted. The custom was "for the safety of the ship" or as the court put it, "ex justa causa". The court stated at p. 351:

> "Here the defendants knew that the tackle and furniture would be put in this bank-saul, as the usual, certain consequence of the voyage at sea; which always made it necessary to heel, clean and refit the ship in the river of Canton. Had the insurers been asked, they must, for their own sakes, have insisted they should be put there as the best and safest method. They would have had reason to complain, if, from their not being put there, a misfortune had happened: in that case the master would have been to blame, and by his fault would have varied the usual chance."

A custom and usage to protect the safety of insured property on a specific, disclosed voyage as in *Pelly, supra,* demonstrably gave the lower court no authority to recognize in the instant case a custom which deliberately exposed insured property to a grave risk.

The intrinsic vice of overloading precluded the lower court from recognizing it as a usage. The principle is plainly stated in *N.Y. Jur., Customs and Usages* § 20:

> "It is a well-settled general rule that a custom or usage is not operative so as to affect the rights of the

> parties to a contract if it is contrary to law or the general or public policy. A custom is likewise invalid where it is based on a disregard of the relations which exist between men, or the duties which in law and morals they owe to each other, or is obviously contrary to justice and fair dealing."

It was manifest error for the court to recognize as a usage conduct which is in contravention of civil and criminal law, dangerous, immoral and an incentive to defraud.

In *Cudahy Packing Co.* v. *Narzisenfeld,* 3 F. 2d 567 (2 Cir. 1924) the court held that a custom and usage could not be invoked which would contravene the New York Personal Property Law. The court stated at p. 572:

> "It is well settled law that usage will not be allowed to subvert an established rule of law. To allow this to be done, as was said in Barnard v. Kellogg, 10 Wall. 383, 391, 19 L. Ed. 987, would lead to mischievous consequences, embarrass trade, and be against public policy."

Again, in *Central R. Co. of New Jersey* v. *Shick,* 38 F. 2d 968 (3 Cir. 1930), the court held that proof of a usage or custom repugnant to the provisions of a New Jersey statute would be void and of no effect, citing for that proposition *Cudahy Packing Co., supra.*

An analogous case is *Ramsauer, et al.* v. *U.S.,* 21 F. 2d 907 (9 Cir. 1927). Plaintiff seamen alleged a custom by which American sailors in the Pacific trade worked from 8 a.m. until 5 p.m. on weekdays and were paid overtime for all other work. The court rejected the alleged custom because it was contrary to § 2 of the Seamen's Act of March 4, 1915, 46 U.S. Code § 673, which required that crew members on vessels of more than one hundred tons be divided into watches. The cited statute was, like the Load Line Act, 46 U.S. § 85, *et seq.,* a safety statute enacted by Con-

gress to ensure that alert and wakeful personnel would always be on watch aboard ship. The court declined to recognize the alleged cutom and usage because it would be contrary to the safety statute.

In a variety of factual situations, the courts have refused to notice customs and usages contrary to statute or in contravention of common law principles:

Walker v. *The Transportation Co.*, 70 U.S. (3 Wall.) 150 (1865).

(Usage that vessel owners be responsible for fire damage caused by negligence of their officers rejected as contrary to the Fire Statute enacted by Congress March 3, 1851, 9 Stat. at Large, 635.)

* * *

Franklin v. *Shelton*, 250 F. 2d 92 (10 Cir. 1957), cert. den. 355 U.S. 959.

(Custom to use a highway contrary to the statutes of the State of Oklahoma rejected.)

* * *

THE STAR, 53 F. 2d 890 (W.D. Wash. 1931).

(Custom for salvage services to be rendered without obligation by distressed vessel to pay rejected as contrary to admiralty law and public policy.)

* * *

THE LAFAYETTE LAMB, 20 Fed. 319 (W.D. Wisc. 1884).

(Custom not to display navigation light on barge rejected as contrary to statute and regulation.)

* * *

Jaynes v. *First National Bank of Ketchikan, Alaska*, 236 F. 2d 258 (9 Cir. 1956).

(A practice of bank examiners to charge excessive bank loans to undivided profits rejected as contrary to Title 12 U.S.C. § 84.)

* * *

Matter of Western Union Telegraph Company, 299 N.Y. 177 (1949).

(Usage of a union local not on strike to refuse to handle traffic from struck telegraph offices void as contrary to New York Penal Law.)

* * *

Oksa v. *American Employers' Insurance Company,* 137 N.Y.S. 2d 871 (1953).

(Custom and usage of issuing insurance endorsements with changing statutory provisions rejected as contrary to Vehicle and Traffic Law.)

* * *

Anglo-African Merchants, Ltd. v. *Bayley,* (1969) 1 Lloyd's Rep. 268.

(Custom of insurance agents to serve two principals without disclosure of adverse interest rejected as contrary to British law.)

* * *

Upon the foregoing authorities, the lower court was precluded from recognizing an alleged usage among shipowners to overload their vessels at Freeport. The usage which the lower court erred in recognizing involved prima facie unseaworthiness, the deliberate risk of life and property for greed, violation of the Load Line Act, 46 U.S. Code §§ 85-85g and breach of a criminal statute, 46 U.S. Code § 658. The inherent evil of the alleged usage required its rejection by the lower court.

If the inherent vice of the alleged overloading usage were not enough to preclude the court from invoking it,

the essential elements to prove a usage were lacking in the trial record. Before the existence of a custom or usage can be found, substantial evidence must show that the custom amounts to a long-standing, definite, uniform, known practice which, in addition, is not unreasonable or unlawful.

> *McClellan* v. *Pennsylvania R. Co.*, 62 F. 2d 61 (2 Cir. 1932).

Custom and usage must be proven by a succession of instances of actual practice and not by the individual opinions of witnesses as was attempted herein.

> *Parkway Baking Company* v. *Freihofer Baking Company*, 255 F. 2d 641, 646 (3 Cir. 1958).

In *Bowling* v. *Harrison*, 6 How. 248 (1847), the United States Supreme Court stated at pp. 259-260:

> "Those who affirm the existence of such a strange usage should be held to strict proof of it; and the court were right in not submitting it to the jury to infer such an improbable and unreasonable custom, by forced or astute construction of equivocal expressions from a willing witness."

That bit of wisdom could as well have been uttered of the proof of alleged usage in the instant case. In a classic example of bootstrapping, the court cited plaintiffs' own misconduct in overloading at Freeport as evidence of the very custom and usage which plaintiffs proclaimed to excuse their non-disclosure of material facts.

The lower court obviously misunderstood the significance of the Dyson shipping records, India Exhibits 1-3. The court had the erroneous impression that the Dyson records established overloading (23a, 25a). Plainly, they did not. Mr. Diamond testified that Dyson Shipping was the exclusive shipping agent for the government of India during

1962 through 1964 (104a). His firm's records, India Exhibits 1-3 (422a-452a) simply showed in Column 1 the chartered tonnage for each ship and in Column 10 the tonnage loaded by each ship. Mr. Dyson pointed out that the chartered tonnages in Column 1 were subject to a leeway of five percent to ten percent, more or less, as indicated by the figure after the tonnages in Column 1 for each ship (108a-109a). The District Court erroneously assumed that any ship which loaded more than the chartered tonnage shown in Column 1 was overloaded even though the actual tonnage loaded was within the five percent or ten percent leeway. That was a misunderstanding of the exhibits.

Counsel for the government of India, selecting at random a vessel from the exhibits, PORTLAND VICTORY, demonstrated that India Exhibits 1-3 disproved rather than proved overloading (110a-111a). The PORTLAND VICTORY, according to India Exhibit 2 (434a), was chartered (Column 1) for 10,000 tons with a leeway of five percent more or less and actually loaded (Column 10) 9,600 tons. The vessel's deadweight capacity was 10,818 tons (111a). Thus, the vessel had available 1,218 tons for fuel water and stores representing the difference between 10,818 long tons deadweight capacity and 9,600 long tons of cargo loaded. There is no evidence as to the route traveled by the PORTLAND VICTORY or any other vessel to India. If she took the SMITH VOYAGER's ill-fated route, 1,218 long tons, available for fuel, water and stores, was well in excess of the 832 long tons which would typically be required between Freeport and Ceuta (201a). The PORTLAND VICTORY could not have been overloaded.

Mr. Dyson also testified that India Exhibits 1, 2 and 3 did not show the vessels' itineraries, intermediate ports of call or rates of fuel and water consumption (115a-116a). Without that information, there was no basis to infer that any of the ships listed in Exhibits 1-3 were overloaded. Yet that is precisely what the lower court did (23a, 25a).

Finally, the intervenors produced two witnesses, Scarpello and DiVenti, two mariners claiming remarkable memories. Scarpello said that he had been employed on two vessels—the COLUMBIA and the MISSOURI—both of which were owned by Oriental Exporters. These vessels supposedly carried bulk cargoes from United States Gulf ports to India in 1964 (137a). At first, he testified that the vessels departed from Gulf ports with sufficient fuel to get to the Suez Canal in one instance, and to Ceuta in the other (135a). Prompted by intervenor's counsel, he then said that the vessels may have called at Freeport "if I remember right" (135a).

Scarpello just may not have remembered "right" because the Dyson records showing the ships carrying grain to India during 1962 through 1964 do not include any vessel named MISSOURI (India, Exhibits 1-3, 422a-452a), nor do they disclose that the COLUMBIA carried any grain to India in 1964. Dyson was the exclusive shipping agent for India during those years (104a). The COLUMBIA, which was chartered for 17,000 tons, ten percent more or less, loaded 16,332 tons and departed New Orleans August 3, 1962 for Bombay (439a). According to Lloyd's Register of Ships, her summer deadweight was 23,402 long tons. On this trip, she had 7,070 tons available for fuel, water and stores, suggesting that Mr. Scarpello may, indeed, not have remembered "right" about her being overloaded. He did not have with him the itineraries actually followed by the two ships on the voyages (137a).

If he remembered "right" that he had been to Freeport twice, it was his opinion that his vessels departed both times overloaded. After pointing out to the court that drafts were hard to read at Freeport because of the heavy swell running there (138a), he modestly stated that he saw some other unnamed ships at Freeport which were loaded below their marks (139a). Scarpello's most significant contribution to the trial record may have been his state-

ment "when you put a ship below its marks, that's less time that you have to get off that ship if it starts to leak on you."

DiVenti, the other witness, wanted it known that although he had a master's license, he had never sailed as a master (140a). He stated that at some unspecified time prior to August 1964, he had called at Freeport twice as a third officer aboard the TRANSINDIA and the MOUNT RAINIER (140a). His memory, too, may have been flawed. The Dyson records (India, Exhibits 1-3, 422a-452a) do not disclose that a vessel named MOUNT RAINIER carried any cargo to India between 1962 and 1964. The TRANSINDIA was chartered for 20,000 tons of grain, plus or minus ten percent and loaded 21,803 tons, sailing December 13, 1962 from Baton Rouge for Bombay (434a). According to Lloyd's Register of Ships, the TRANSINDIA's deadweight tonnage is 24,418 tons. Thus, the vessel had 2,615 tons available for fuel, water and stores rendering it unlikely that she departed Freeport overloaded. The TRANSINDIA made a similar voyage from Galveston to Bombay sailing March 11, 1962 with 2,418 tons available for fuel, water and stores (442a). The TRANSINDIA departed Destrehan March 23, 1964 with 2,776 tons available for fuel, water and stores.

Even if believed, Scarpello and DiVenti can scarcely be said to have proved a custom and usage which was definite, uniform and long-established—let alone, reasonable and not unlawful or contrary to public policy.

The District Court overstated the stipulation concerning the testimony which Captain Garth Read of the United States Coast Guard would have given if called as a witness. All that was stipulated was that he would say the Coast Guard was aware of overloading at Freeport. It was not stipulated that Read would have testified that overloading

was a long-standing, customary, usual and expectable practice invariably followed by vessels calling at Freeport.

The lower court's finding of an alleged custom of overloading in Freeport was a mixture of non-existent and misunderstood evidence.

Similarly, the court's imputation to defendant of knowledge of the alleged overloading practice was not based on evidence. "Widespread knowledge" (23a) among insurers of overloading was not shown. The lower court cited the testimony of Dwelly that on November 15, 1962 he attended a regular monthly meeting of the Board of Managers of the American Hull Insurance Syndicate where a member commented that he believed a number of vessels were sailing from Freeport overloaded (120a-121a). The minutes of that meeting were distributed to each of the insurers represented on the Board of Managers (23a-24a). The lower court overlooked the testimony that defendant was not a member of the American Hull Insurance Syndicate (123a), was not present at the meeting of November 15, 1962 (120a) and did not receive a copy of the minutes of that meeting. Defendant was prohibited by anti-trust law considerations from communicating about risks with the American Hull Insurance Syndicate (56a).

The minutes of the November 15, 1962 meeting of the Syndicate's Board of Managers (457a) do not disclose a custom and usage of overloading at Freeport, nor do they indicate that the Syndicate's Board of Managers was prepared to accept the risk of overloading. The distribution of the minutes of the November 15, 1962 meeting of the Board of Managers of the American Hull Insurance Syndicate to the companies which were represented at the meeting can scarcely be characterized as "widespread knowledge" in the insurance industry of overloading.

There is no evidence that the information in the minutes was disseminated by the recipients to other insurers. There

is no evidence that the subject of overloading at Freeport was ever discussed at any convention or assemblage of the marine insurance industry. There is no evidence that any alleged practice of overloading at Freeport was publicized in any newspaper or periodical of broad circulation in the insurance industry in 1963 or 1964.

The lower court had a mistaken impression to the contrary. The court stated (25a):

> "The evidence at trial also disclosed that information about destinations of chartered vessels and tonnages of cargoes carried, *which revealed the practice of overloading,* was regularly published in industry publications, to which Defendant had access or subscribed." (emphasis added)

In a footnote purporting to support that statement (25a), the court referred to Maritime Research Service and the Journal of Commerce. Both organizations would undoubtedly be astonished to learn that they published information which revealed a practice of overloading at Freeport or elsewhere. No copies of either publication were offered in evidence to show what they contained. But intervenor, India's witness Dyson, testified that the Maritime Research Service simply publishes reports of the charters fixed as of Friday each week with the contracted tonnages for each charter (112a). He also testified that the Journal of Commerce also publishes the same type of information (112a).

No one ever explained, least of all the lower court, how a newspaper report that a vessel has been chartered for a certain tonnage, proves that the vessel is overloaded. Proof of overloading requires facts—the vessel's deadweight capacity, the weight of cargo, fuel, water and stores actually loaded, the seasonal areas or zones through which the vessel will proceed, the ports where bunkers will be loaded enroute and the vessel's ton per inch immersion factor (93a-95a, 197a-201a).

The lower court's statement quoted above was fiction. The District Court lacked any basis to impute to defendant's marine underwriter, Mr. Blackman, knowledge of overloading which he categorically denied that he had.

POINT II

Policy DE 3540, If Valid, Excluded Plaintiffs' Loss by its Express Terms.

The court's attention is invited to the first exclusion in policy DE 3540 (165a). Exclusion I(a) provides:

> "This policy shall not apply to indemnify an Assured whose dishonesty or fraud, committed individually or in collusion with others, caused the loss for which that Assured seeks indemnity."

While the District Court's opinion notes defendant's assertion of the Exclusion, the lower court wholly neglected to determine its effect on plaintiffs' claim. It is a well-defined concept of marine insurance law that an insured's willful exposure of the property insured to a known risk is fraud.

> *Standard Marine Insurance Co.* v. *Nome Beach L. & T. Co.*, 133 Fed. 636 (9 Cir. 1904), cert. den. 200 U.S. 616;
> *Sorenson* v. *Boston Insurance Co.*, 20 F. 2d 640 (4 Cir. 1927), cert. den. 275 U.S. 555.

The essential element of the fraud is the insured's willfulness or design, as distinguished from mere negligence in exposing the property insured to a known risk.

> *New York, New Haven & Hartford R. Co.* v. *Gray*, 240 F. 2d 460 (2 Cir. 1957), cert. den. 353 U.S. 966.

The principle is codified in Great Britain in the Marine Insurance Act, 1906, § 39-(5) which states:

> "In a time policy there is no implied warranty that the ship shall be seaworthy at any stage of the adventure, but where, with the privity of the assured, the ship is sent to sea in an unseaworthy state, the insurer is not liable for any loss attributable to unseaworthiness."

There can be no doubt in this case that plaintiffs' overloading of the SMITH VOYAGER was done willfully by design and did not occur as a result of a mere negligent act or omission.

The District Court's finding (22a) of a consistent practice by plaintiffs to overload their vessels at Freeport dispels any notion that plaintiffs' overloading was inadvertent. The SMITH VOYAGER was deliberately overloaded at the direction of Fitzsimmons who ordered the master to load 10,200 tons of grain at Houston and to take on sufficient fuel and water at Freeport for the crossing at Ceuta. Fitzsimmons knew he was overloading because he prepared the stability calculations for the voyage.

Petition of Long, 439 F. 2d 109 (2 Cir. 1971).

Defendant's Exhibit J (197a-289a) shows that in addition to Freeport, plaintiffs overloaded their vessels at numerous other ports as well. The loading instructions given to the masters by plaintiffs' vice-president uniformly directed them to load at least 10,200 long tons of cargo and warned them about the risk of being fined if they arrived overloaded at Indian ports (Exhibit AG, 29[illegible]-341a). The directed tonnage made overloading of the plaintiffs' vessels inevitable (Exhibit J, 201a).

Charges were brought against the master of the SMITH BUILDER by the Indian government because that vessel

arrived at Madras on October 26, 1963 overloaded (Exhibit AH, 348a-357a). The master of the same vessel was charged by the United States government for overloading the SMITH BUILDER on September 25, 1963 at Freeport, on October 6 at Ceuta and on October 17, 1963 at Djibouti (344a). Plaintiffs were not only aware of this misconduct, but took a cavalier attitude about it. On August 17, 1964, the day before policy DE 3540 was bound, plaintiffs' vice-president Fitzsimmons wrote the master of the SMITH BUILDER concerning the Coast Guard's overloading charge, stating:

> "You will also probably receive a slap in the wrist without any suspension of license." (342a)

So deliberate was plaintiffs' overloading that the masters communicated pridefully with vice-president Fitzsimmons about their ingenious methods of concealing overloading and alerting him to the ports which were strict about it. On July 13, 1963, the master of the SMITH TOURIST wrote plaintiff Earl J. Smith & Co., Inc. reporting (360a):

> "The vessel was sitting in the mud at the berth in Galveston and the Surveyor said if we loaded more than 10,100 he would have to ride the ship out in the stream and measure the draft and freeboard and if we were any overloaded we would have to return and discharge. So I decided to let well enough alone. After dark a hose was hooked and an additional 90 tons of water was taken.
>
> In Freeport you are out in the surf and it is impossible to read the draft so you can load what you want.
>
> At Ceuta they inform you that your vessel is overloaded and after a present of a few cartons of cigarettes they do not bother you."

In the same letter he explained how he got away with overloading at Aden (360a):

> "After waiting three hours the pilot came out checking the plimsol marks and told he would not take me in as we were then on Summer marks and would not be allowed to load any fuel or water. I told him I would have to pump out water to take fuel to get to Bombay. He insisted on looking at the store list to see how much I declared then condesended to take us in to the Bouys. It took three hours to tie up. I went to see the Agent and he suggested that I talk to the harbor master whom he described as a reasonable fellow. I explained that a very minimum of fuel and water to get us to Bombay would put us over the marks after talking a while he agreed not to hold us for one or two inches but not over that. I returned to the vessel and had a port list put on the ship and hired a bumboat to tie up along side the submerged port plimsol mark. When the pilot came aboard he satisfied himself by checking the starboard side closely not noticing the list. We sailed four or five inches over the summer marks."

On the following day, July 14, 1963, the chief mate of the SMITH TOURIST wrote a letter to plaintiff Smith showing that he, too, wished to be recognized for his prowess in overloading (Exhibit AH, 362a-363a). His glib reference to bribery is to be noted. On March 9, 1964 the master of the SMITH PILOT wrote plaintiffs' vice-president Fitzsimmons stating (366a):

> "That 10,200 is pretty rough and I was worrying about making it but I think that Texas Nautical Co. has a connection as no one showed up to check our draft or I would have had to do some fast talking."

Plaintiffs received payment on freight based upon the number of tons loaded. Motivated by greed, they deliberately risked their vessels, their crews and their cargoes

for the additional freight payable on the tonnage loaded over the vessels' legal limits. Their losses resulting from the sinking of the SMITH VOYAGER were attributable to fraud and were excluded by the express provisions of policy DE 3540.

There is a significant difference between Exclusion I(a) and Exclusion I(b). Exclusion I(a) denies coverage to assureds whose fraud "caused" the loss. Exclusion I(a) is applicable to plaintiffs because they directed and sought to profit from the overloading of the SMITH VOYAGER. If there had been additional assureds who did not participate in the overloading of the SMITH VOYGER, but were subjected to claims for bodily injury, death or property damage resulting from it, coverage of such assureds would be saved by the exception to Exclusion I(b). A typical example might be an owner out of possession of a vessel bareboat chartered to another.

The premises for the lower court's concept of public policy in the interpretation of Exclusion I(b) are deficient. The trial record clearly established that the premium for policy DE 3540 was computed without reference to the overloading which plaintiffs concealed and that if overloading had been disclosed, the policy would not have been issued. The notion that the limitation claimants were innocent of any wrongdoing or had equities superior to the defendant's, is questionable. Any crew member who sailed the SMITH VOYAGER could readily see that she was loaded below her plimsol mark. Apart from their power as union labor to refuse to sail the ship, American seamen have a statutory right pursuant to 46 U.S. Code § 653 to cause an inquiry to be made into any condition of unseaworthiness before a vessel departs on a voyage. In any event, the validity of the policy and the coverage it afforded depends on plaintiffs' conduct, not the claimants'.

Rushing v. *Commercial Casualty Insurance Co.*, 251 N.Y. 302 (1929);

Weatherwax v. *Royal Indemnity Co.*, 250 N.Y. 281 (1929);
Coleman v. *New Amsterdam Casualty Co.*, 247 N.Y. 271 (1928);
Lee v. *Aetna Casualty & Surety Co.*, 81 F. Supp. 1008 (S.D.N.Y. 1949), aff'd 178 F. 2d 750.

When defendant's counsel sought to interrogate Mr. Diamond about the possible complicity of the government of India in the overloading of plaintiffs' vessels, the lower court shut off the inquiry (114a-115a). That occurred when defendant's counsel inquired:

> "Q. Is Dyson, as the agent of the Indian Government not interested in knowing the dead weight capacity of the vessel?
>
> Mr. Meshell: I object to this line of questioning for two reasons. First of all, the question is improper, second of all, whatever fault they are trying to attribute at this point, it's after the limitation proceeding. This is only the question of the insurance company's constructive knowledge, not Dyson's.
>
> The Court: I will sustain the objection to that one."

The crew was content to sail an overloaded vessel; the Coast Guard's punishment of masters for overloading was considered by plaintiffs "a slap in the wrist". Paramount considerations of the safety of property and life at sea require an effective deterrent to overloading. The lower court's concept of public policy encourages the shipowner to overload, secure in the knowledge that the consequences of a mishap can be foisted on his defrauded insurer. Shipowners should be made to understand that the deliberate overloading of their vessels deprives them of all insurance protection.

CONCLUSION

The judgment of the District Court should be reversed and the complaint should be dismissed.

Respectfully submitted,

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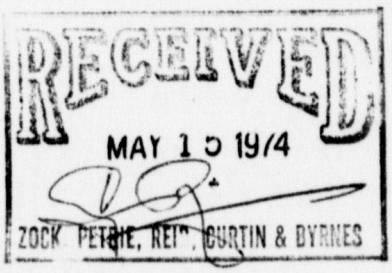
Service of two copies of the within brief is hereby admitted.



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